404(a)(5) Fee Disclosure: A Sponsor’s Guide to Understanding Participants’ Concerns

The Department of Labor’s (DOL’s) 404(a)(5) fee transparency efforts are designed to provide participants with at least an annual—and in some cases a quarterly—breakdown of the fees that they are directly incurring for plan administration, investment management, and advisor services, effective for plan years beginning on or after November 1, 2011.

Based on several industry surveys, it is anticipated that many participants—some of whom will be seeing the fees for the first time expressed as an explicit dollar amount—are going to have questions. The following information can be used as a starting point to help sponsors address participant questions and concerns that arise from the new regulations.

Help participants understand which fees they may incur and what they’re getting for each.

There are two broad categories of fees and expenses. The first is administrative, and the second is individual. And what you get for each differs. Administrative fees and expenses are paid by everyone in the plan and cover the cost of operating the plan. Individual fees are charged directly to your own account and are related to your investments or the plan services you access.

- Administrative fees and expenses include your share of the cost of:
  - Customer service representatives
  - Legal services
  - Accounting services
  - Recordkeeping
  - Account statements
  - Financial education materials

- Individual expenses and fees include the costs of services that you may incur, including:
  - Loan processing
  - Qualified Domestic Relations Orders (QDROs)
  - Investment advice
  - Brokerage windows

- Investment-related fees and expenses that you could be charged as a result of your investment selection and activity include:
  - Commissions
  - Sales loads
  - Sales charges, deferred sales charges
  - Redemption fees
  - Surrender charges
  - Exchange fees
  - Account fees
  - Purchase fees

The IRA vs. 401(k) debate.

Participant concerns may lead them to ask about switching to an IRA. While each type of savings vehicle has its advantages and disadvantages, remind participants that their 401(k) plan has benefits that IRAs don’t, including any company matching contributions and the option of contributing more pretax money to their account. (For 2013, those under age 50 can contribute $5,500 annually to an IRA, but the contribution limit for a 401(k) is $17,500. Those over age 50 can contribute up to $23,000 to a 401(k).) And while IRAs may have lower or no administrative fees, the larger size of an employer’s 401(k) plan may provide access to lower-cost investments than may be available in an IRA.

To reduce costs, some participants may want to choose the investments in the plan with the lowest fees.

Just because an investment has lower expenses does not mean that it will provide the highest return or that it is a good fit for a portfolio. In addition to—and sometimes more so than—the fee, participants will also want to consider the quality of the investment, as well as the risk/return profile. The best course of action may be to identify investments that make sense for their asset allocation strategy and time horizon and then compare fees.

These fees and expenses aren’t new, so let participants know why they’re learning about them now.

Recent DOL regulations now require plan sponsors to provide fees and expenses in a more open and consolidated manner, even though this information may have always been available to participants in a variety of places and formats (e.g., on a quarterly statement or a section of the website). In addition, while the fees may have been previously communicated as a percentage of assets or in the form of an expense ratio, participants will now see them expressed as explicit dollar amounts.

It’s difficult to compare fees from plan to plan.

In addition to choosing the investment lineup, part of a plan sponsor’s job is to negotiate, on behalf of participants, for the best deal possible. But it’s difficult to compare fees across plans, because different plans offer different services and carry different investment lineups. In addition, the size of a company can greatly influence costs, as can a participant’s individual investment behavior (e.g., consistently taking loans from their account). Finally, it’s important to note that lower fees do not always indicate a better plan.

Not intended for individual investor use.
Participant Fee Disclosure Regulations – Summary

The regulations state that on or before the date participants can first direct their investment and at least annually thereafter, plan sponsors must send a disclosure to participants:

Plan-Related Information

General Plan Operational and Identification Information

- An explanation of the circumstances under which participants may give investment instructions
- An explanation of any specified limitations on such instructions, including any restrictions on transfers to or from a designated investment alternative
- A description of (or reference to) plan provisions relating to the exercise of voting, tender, and similar rights with respect to a designated investment alternative, including any restrictions on such rights
- Identification of the designated investment alternatives offered under the plan
- Identification of any designated investment managers
- A description of any “brokerage windows” that enable participants to select investments beyond those designated by the plan

Plan Administrative Expenses

An explanation of any fees and expenses for general plan administrative services (e.g., legal, accounting, or recordkeeping) that may be charged against participant accounts and the basis on which such charges will be allocated (e.g., pro rata or per capita).

Individual Expenses

An explanation of any fees that may be charged against participant accounts on an individual rather than a plan-wide basis, such as fees associated with processing loans, fees for Qualified Domestic Relations Orders (QDROs), fees for investment advice, fees for brokerage windows, commissions, loads or sales charges, and redemption fees.

Quarterly Disclosure of Fees and Expenses

At least quarterly, plan administrators must disclose to participants the plan administrative expenses and individual expenses that are actually charged against their accounts during the preceding quarter, as well as a description of the services to which the charges relate. The quarterly disclosure may be provided as part of a quarterly pension benefit statement furnished to participants. If applicable, the quarterly disclosure should also include a statement explaining that some of the plan’s administrative expenses for the preceding quarter were paid from the total annual operating expenses of one or more of the plan’s designated investment alternatives (e.g., through revenue sharing arrangements).

Investment-Related Information

The following must be disclosed to participants on or before the date participants can first direct their investment and at least annually thereafter:

- The name of each designated investment alternative
- Identification of the type or category of the investment
- The following performance data and benchmarks, as applicable:
  - For investment alternatives with respect to which the return is not fixed, the average annual return of the investment for the 1-, 5-, and 10-calendar year periods (or for the life of the investment, if shorter) and the name and returns of an appropriate broad-based securities market index over the periods
  - For investment alternatives with respect to which the return is fixed, both the fixed or stated annual rate of return and the term of the investment and the current rate of return; the minimum rate guaranteed under the contract, if any; and a statement advising participants that the issuer may adjust the rate of return prospectively and how to obtain the most recent rate of return
- The following fee and expense information:
  - The amount and a description of each shareholder-type fee (i.e., commissions, sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees) that is not included in the total annual operating expenses of the investment
  - A description of any restriction or limitation that may be applicable to a purchase, transfer, or withdrawal of the investment in whole or in part
  - For designated investment alternatives with respect to which the return is not fixed, the total annual operating expenses of the investment expressed as a percentage and as a dollar amount for a $1,000 investment
  - An Internet website address to provide participants access to supplemental information regarding the investment
- A general glossary of terms to assist participants in understanding the plan’s designated investment alternatives or an Internet website address to provide access to such a glossary

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